



Observations: Integrated Resource Plan and Evaluation Bids

We reviewed each of the documents provided to us in reference to the EURCSA. Our focus was the information pertaining to natural gas price forecasting. Our finding was that the information contained in the Evaluation Bids and the Integrated Resource Plan was disconcertingly brief despite its important underlying influence on both the Reference case pricing and the pricing of the Conectiv Energy proposal. Only general information regarding the process has been included. We feel that more documentation should be included to support the assumptions on which the case is built. The fuel costs for natural gas and oil can single-handedly eliminate each proposal submitted to Delmarva.

Although our long-term forecast correlates roughly with the outlook presented by both ICF and EIA, our experience in the natural gas market has proven that it is important to present at least one high natural gas price scenario, particularly if the time horizon extends as far as the case considered in these documents. We often provide multiple scenarios that include second and third tier forecasts which, although less probable, are factored into the on-going market strategy. The events upon which the ICF and EIA outlooks focus require a considerable amount of confluence between regulatory concession, corporate activity and economic determinants, all of which are vulnerabilities which could cause price dislocations of magnitudes far in excess of any previously experienced. For this reason, we believe it is imperative that at least one high case be presented and thereafter averaged into the net costs foreseen for both the Reference scenario and the Conectiv bid.

The natural gas market has been on a long-term upward trend that has lasted the entire 16 years of its history and it has yet to be tested significantly. The major driver behind this developing trend is the growth in usage and a growing scarcity of domestic supply, both of which are anticipated to follow the current trajectory for the foreseeable future. Without any additional information at hand, this gives credence to the possibility and lends weighting to the probability that natural gas prices could continue higher, particularly without the advent of significant LNG deployment.

The 25 Year Forecast marketplace is scarce. Most outlooks for this purpose are made in-house or as specialty projects by consulting groups for specific long-term planning and receive little public attention. However, from our vantage point, a majority of the long-term outlooks for natural gas and crude oil expect higher average prices as the US market progresses into the middle of the next decade. Admittedly, our exposure to these outlooks may not be exhaustive, but it is substantial enough to merit recognition in this analysis.



The sensitivity analysis is the most importance consideration for BlueWater to pursue. We have included a list which summarizes the aforementioned points as well as some other suggestions which may be useful in your response to these evaluation reports.

Important Considerations:

- 1) IFC should provide additional natural gas forecast substantiation.
- 2) A minimum of one bullish forecast consideration should be considered as part of the sensitivity analysis and weighted into the net price of the Reference case and the Conectiv bid.
- 3) One major assumption among each of the forecasts is the deployment of LNG import facilities. This requires the alignment of regulatory, corporate and economic considerations, all of which are major wildcards over the time interval contemplated.
- 4) Natural gas futures prices have been consistently upward trending throughout the 16 year history of the NYMEX market. The projections provided assume that the trend will change and prices will begin to move more sideways. Basic pricing theory suggests it will continue along the long-term trend.
- 5) One way to gauge the cost of natural gas and therefore power prices into the future is by referencing the current forward market prices in either or both markets. However, the time horizon available for trading in natural gas is limited to six years and is only five years for electric power. Even with these prices available, assuming them as a forecast for future pricing does not account for the total cost of purchasing power and/or hedging natural gas on the forward markets. Margins and related costs of capital should be factored into the combined cost for natural gas and/or power.
- 6) When the Public Service Commission contemplates a program of this kind, they are almost always aware that at some points in the future, the pricing of the alternative supply will exceed that created by the current practices. There is rarely an expectation that prices will not flux above and below the existing method of purchasing fuel on behalf of the ratepayers. By the very nature of transitioning to a new practice, variation of some kind should be expected. The value of price stability is often preferred to beating the “market price” or some other benchmark upon which hindsight review is made. It is our opinion that price stability should be more highly ranked in the scoring system, particularly since it was a major dislocation in prices that motivated the call to action.
- 7) If the Public Service Commission initiated this change, then regulatory action could be implemented to resolve any stranded costs created by Delmarva’s opting into one of the bids. The stranded costs may be created by the movement of subscribers off the program or by the difference in price between the Reference case and the choice of one of the candidates currently competing for this bid. We would expect that said “costs” would be disseminated across the ratepayer base, not just to Delmarva’s customers.



Gelber & Associates
712 Main St., Suite 1710
Houston, TX 77007
Tel: 713 655-7000
Fax: 713 655-1623

- 8) We noted that in the Evaluation Reports, the scoring of bids was hurt by the fact that BlueWater presented more than one bid and therefore had to split points between its two submissions at times. A single bid may help to push the Bluewater score closer to that of Conectiv.